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# Financial Transaction Tax

Valerie Vlasenko

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# FINANCIAL TRANSACTION TAX

Valerie Vlasenko

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## INTRODUCTION

Following the 2007 economic downturn, the European Commission (Commission) proposed a directive that would institute a financial transaction tax (FTT) that would provide the EU and Member States with revenue that would counter the cost of the crisis, help regulate the financial market, harmonize the already existing national FTTs, and allow the EU to become financial independent of the Member States.

The 2007 financial crisis has been attributed largely to risky behavior in the financial market. The economic crisis brought on by short term speculative trading which was facilitated by innovations in the financial market. The high risk behavior of financial institutions emphasized the need of the regulatory and supervisory framework of the financial market in the EU. Moreover, the crisis was immediately followed by substantial bailouts of financial institutions, which resulted in devastating debt in the European Union (EU) and governments of Member States.

This has led to a discussion on what fiscal measures should be taken to recoup the money provided to financial institutions during the bailouts, force financial institutions to make fair and substantial contributions to the EU and the Member States, and how to create a regulatory framework that would prevent another financial crisis. Several individual EU Member States that have begun to independently put in place national tax instruments to respond to challenges brought on by the financial crisis of 2007. Having a nation FTTs that vary in reach and scope can lead to fragmentation if the single market in the EU. A European Union FTT can create a coordinated framework that would harmonize the national FTT and prevent tax arbitrage and distortion between financial markets of the Member States. Section I of this paper examines, in detail, the purposes and benefits of the FTT.

Under the authority of Article 113 of the Treaty of the Functioning of the European Union, the Commission drafted a proposal for a FTT to be implemented by all Member States. The proposal, discussed in Section II of the paper, called for a FTT that applied to the transfer of a broad range of financial instruments between financial institutions and would be collected by the Member States. The Commission's Proposal was met with criticism. Because a directive in the area of taxation requires unanimous consent, the proposal for a directive concerning the FTT was rejected.

However, the Proposal motivated Denmark, France, Austria, Belgium, Greece, Italy, Portugal, Slovakia, Slovenia, Germany, and Spain to work together in the area of the FTT under the enhanced cooperation procedure. Section III of the paper examines the enhanced cooperation procedure in the area of the FTT. After the approval of the enhanced cooperation by the European Council (Council) and the European Parliament (Parliament), the Commission drafted a proposal for a directive in the area of the FTT that would be binding on the Member States that wish to participate in the enhanced cooperation.

The Commission's proposal for enhanced cooperation in the area of the FTT largely mirrored the original proposal. However, because enhanced cooperation would only involve eleven Member States rather than the entire EU, the Commission broadened the scope of the tax. Financial institutions that are not residents of Member States that have FTT jurisdiction would be taxed if they enter into transaction with parties who are established in FTT jurisdictions. Moreover, the Commission also encourages Member States to tax financial instruments that are issued in FTT jurisdictions.

Similarly to the Commission's initial proposal, the proposal for enhanced cooperation has been subject to heavy criticism. In particular, for the effect that Member States with FTT

jurisdiction have on Member States without jurisdiction because of the broad tax base. However, the Commission feel that the proposal for enhanced cooperation respect the competences, rights, and obligations of the Member States who have chosen not to participate in the cooperation because if financial institution are conducting business with institutions established in FTT jurisdiction have a sufficient nexus to the jurisdiction to be taxed.

Despite the criticism, enhanced cooperation in the area of tax would be a great beginning to harmonizing the FTT in the EU. The participating Member States and the EU would benefit from the revenue collected as a result of the FTT and the tax would provide an incentive to stop high risk behavior among financial institutions.

## I. THE EUROPEAN UNION AND THE NECESSITY OF A FINANCIAL TRANSACTION TAX

### A. The Financial Sector Should Be Held Responsible for Its Role in the Economic Crisis of 2007 and Should Make a Fair and Substantial Contributions to the European Union and Individual Member States

The financial sector has been found largely responsible for the economic crisis that began in 2007. This crisis resulted in collapse of large financial institutions followed by bailouts of such institutions by both the national governments and the EU.<sup>1</sup> The substantial support that individual Member States and the EU were forced to provide to financial institutions has led to an unprecedented financial burden.<sup>2</sup> For example, in 2011 the financial sector received 714.7 billion euros from the EU to guarantee liquidity.<sup>3</sup> The EU deficit increased to 6.2% of the Gross Domestic

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<sup>1</sup> Benjamin Cortez & Thorsten Vogel, *A Financial Tax for Europe?*, EC Tax Rev. 16 (2011).

<sup>2</sup> *Commission Proposal for a Council Directive Implementing Enhanced Cooperation In the Area of Financial Transaction Tax*, at 2, COM (2013) 71 final (Feb. 14, 2013) [hereinafter *Enhanced Cooperation Proposal*].

<sup>3</sup> *Report from the Commission on State Aid Granted by the EU Members*, at 4, COM (2012) 778 final (Dec. 21, 2012).

Product (GDP)<sup>4</sup> in 2011 because government debt rose to 88% of GDP, from 66% in 2007.<sup>5</sup> This crisis has clearly resulted in the significant budgetary deterioration. Therefore, if no innovative fiscal measures are taken by the EU, the debt to GDP ratio is predicated to increase to 120% in 2020.<sup>6</sup>

Despite its role in the economic downturn, the financial sector in the European Union has been more profitable than the non-financial sectors. Financial institutions in the EU not only enjoy the safety nets provided by governments, but they are also able to avoid value added tax (VAT) that parties in other markets pay.<sup>7</sup> For example, the VAT does not apply to financial services such as investment funds.<sup>8</sup> This leads to under taxations of the financial sector in comparison to taxation of sales from all other sectors.<sup>9</sup>

In an effort to find a means of recouping funds used to bail financial institutions and forcing the financial sector to contribute to the economy, the European Parliament adopted a resolution requesting the Commission to carry out an assessment on the FTT.<sup>10</sup> The FTT would require financial institutions to make a fair and more substantial contribution to both governments of Member States and European Union finances.<sup>11</sup> The introduction of the FTT would not only force the financial sector to make a more substantial contributions to government of Member States and the EU, but also create a level playing field for all markets.<sup>12</sup>

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<sup>4</sup> The Gross Domestic Product is a quantitative measure of a nation's total economic activity. Investopedia, <http://www.investopedia.com/terms/g/gdp.asp> (last visited Dec. 7, 2015).

<sup>6</sup> European Commission Sustainability Report 2009 No. 9/2009.

<sup>7</sup> European Commission Additional Analysis of Impacts and Further Clarification of Practical Functioning (May 4, 2012).

<sup>8</sup> *Id.* at 4.

<sup>9</sup> *Ibid.*

<sup>10</sup> European Parliament Resolution on Financial Transaction Taxes- Making Them Work B7-0122/2010 (March 2, 2010).

<sup>11</sup> *Enhanced Cooperation Proposal, supra* note 2.

<sup>12</sup> *Ibid.*

B. A Financial Transaction Tax Can Dissuade High Risk Transactions, Thereby  
Enhancing the Stability of the Financial Market in the European Union

The financial and economic crisis that began in 2007 highlighted weaknesses in the regulatory and supervisory framework of the financial system in EU.<sup>13</sup> Because a regulatory and supervisory framework is essential to rebuilding a stable financial system in the single internal market that the EU has been striving for, reform has been a priority in the EU. A financial transaction tax can function as a “corrective tax” and enhance the stability of financial markets by dissuading excessive risk-taking that negatively impacts the rest of the economy.<sup>14</sup>

The financial crisis was largely due to financial innovations that have allowed for financial institutions to engage in high risk behavior. More specifically, financial innovations have caused turnover in asset markets significantly easier.<sup>15</sup> The upswing in turnover of stocks, currency exchanges, derivatives, and other financial instruments causes price volatility which, in turn, has a negative impact on long-term economic growth.<sup>16</sup>

Another major contributor to the economic crisis was short term speculative trading, which was facilitated by financial innovations.<sup>17</sup> As its name suggests, short term speculative traders enter into transactions because of speculation and technical analyses of stock performance rather than information such as the fundamental measures in a company or a state. Such speculation causes prices and risk levels to diverge from their fair market value, thereby increasing volatility and jeopardizing market efficiency.

The Commission hopes that targeting such transactions with a tax can reduce the frequency of such transactions and, therefore, decrease volatility, reduce market efficiency, and improve the

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<sup>13</sup> *Enhanced Cooperation Proposal*, *supra* note 2.

<sup>14</sup> *Ibid.*

<sup>15</sup> Cortez, *supra* note 1, at 18.

<sup>16</sup> *Ibid.*

<sup>17</sup> *Ibid.*

economy as a whole.<sup>18</sup> However the effects of reduces frequency are not certain. For example, following the economic crisis, France implemented a FTT.<sup>19</sup> As predicted by the Commission, a trend analysis of the French financial market showed a decrease in volume after implementation of the local FTT.<sup>20</sup> The decrease had no effect on prices and a correlation to market volatility could not be confirmed.<sup>21</sup> Critics of the FTT, however, are concerned that if transaction volume is reduced, individual transaction may have higher weight and can cause stronger deviations in market prices.<sup>22</sup>

#### C. The Financial Transaction Tax Would Help the European Union Become Financially Autonomous and Address Challenged with Significant Budgetary Implications

The FTT can also help the EU become financially autonomous from the Member States. The Treaty of Rome prescribed that the EU would be financed by Member States' contributions until a system of self-financing could be introduced.<sup>23</sup> Beginning in 1980, the EU was financed with levies on manufactured imports from non-Member countries, tariffs on agricultural imports, and a portion of the VAT levied by the Member States.<sup>24</sup> However, after decreasing revenues due to free trade agreements and falling tariffs, the EU began to take a percentage of the Gross Nation Income (GNI) of each Member State.<sup>25</sup>

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<sup>18</sup> Cortez, *supra* note 2, at 18.

<sup>19</sup> Did the French Tax on Financial Transactions Influence Trading Volumes, Price Levels and/or Volatility On the Taxed Market Segment? A Trend Analysis at 19, [http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/other\\_taxes/financial\\_sector/effect\\_french\\_ftt.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/other_taxes/financial_sector/effect_french_ftt.pdf) [hereinafter French Trend Analysis].

<sup>20</sup> *Ibid.*

<sup>21</sup> *Ibid.*

<sup>22</sup> Cortez, *supra*.

<sup>23</sup> Treaty Establishing the European Economic Community, Mar 25, 1957, art. 201, 298 U.N.T.S. 11.

<sup>24</sup> Auke R. Leen, *The European Commission's Financial Transaction Tax and Better Lawmaking*, 19 Colum. J Eur. L. Outline 2 (2013).

<sup>25</sup> *Ibid.*



Aside from the burden placed on the EU budget by the economic downturn and the bailouts discussed out, the EU budget is strained because of challenges in areas of development, resource efficiency, and climate change.<sup>26</sup> For example, the EU provides almost 60% of the Global Official Development Assistance each year, which aggregates to over sixty billion euros per year.<sup>27</sup> Moreover, following the Copenhagen Accord in 2010, the EU has pledged 0.7% of its Gross National Income to aid the needs of developing countries in fighting climate change, which would result in an estimated one hundred billion euros in 2015.<sup>28</sup>

The FTT can be a great source of revenue that would contribute to the areas that the EU has pledged funding to and displace contributions of Member States, thereby alleviating the burden national governments carry.<sup>29</sup> For instance, the Belgium FTT resulted in an average of one hundred thirty million euros collected over year between 2008 and 2012.<sup>30</sup> Similarly, Italy collected approximately one hundred sixty million euros in 2013.<sup>31</sup> France, on the other hand has collected over seven hundred million euro in 2014 alone.<sup>32</sup> If the EU adopted a tax similar to the French FTT, the potential revenue would be about four to five billion euros per year.<sup>33</sup> On the other hand, United Kingdom's long established Stamp Duty Reserve Tax raises more than two

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<sup>26</sup> *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions*, at 1, COM (2010) 549 final (Jul. 10, 2010) [hereinafter *July Communication*].

<sup>27</sup> European Commission Press Release MEMO/1/627, Climate Chance: Questions and Answers On the UN Climate Conference in Cancun (Nov. 29, 2010).

<sup>28</sup> *European Commission Staff Working Document, Innovative Financing at a Global Level*, at 11, SEC (2010) 409 final (Jan. 4, 2010).

<sup>29</sup> *Communication From the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions, the EU Budget Review*, at 4, COM(2010) 700 final (Oct. 19, 2010).

<sup>30</sup> European Commission, Ernst & Young Final Report: FTT- Collection Methods and Data Requirements, at 6 (Oct. 2014).

<sup>31</sup> *Id.* at 8.

<sup>32</sup> *Id.* at 6.

<sup>33</sup> *Commission Staff Working Document, Impact Assessment Accompanying the Document Proposal for a Council Directive Implementing Enhanced Cooperation in the Area of Financial Transaction Tax*, at 13, COM (2013) 71 Final (Feb. 14, 2013) [hereinafter *Staff Working Document*].

billion pounds per year.<sup>34</sup> After examining the revenue received by national FFTs, it is clear that European Union wide FTT could lead to substantial contributions to the EU Budget.

D. The Financial Transaction Tax Framework on the European Union Level is Essential to the European Union's Goals of Harmonization and Creation of a Single Market

One example of a Member State with a successful FFT is the United Kingdom. The United Kingdom's Stamp Duty and Reserve Tax has been in existence for almost thirty years and levies 0.5% tax on transfers of chargeable securities.<sup>35</sup> Several individual EU Member States have begun to independently put in place national tax instruments to respond to challenges brought on by the financial crisis of 2007.<sup>36</sup> Belgium, for example, has levied a tax on the sale and purchase of publicly tradeable securities, with rates between 0.09% and 0.25%.<sup>37</sup> The French apply a FTT only to equities of large companies incorporated in France and high frequency trades that are carried out in France, but has excluded derivatives.<sup>38</sup> Similarly, Switzerland excluded derivatives from its national FTT and limited the tax to transfers of ownership of equities and bonds if one of the parties in the transaction is a Swiss securities dealer.<sup>39</sup> Italy also implemented a FTT on transaction beginning in 2013, which include transfer of title on financial instruments, derivative transactions, and any high-frequency trading on securities and derivatives occurring in Italy in order to raise additional funds for its government.<sup>40</sup>

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<sup>34</sup> European Commission, Ernst & Young Final Report: FTT- Collection Methods and Data Requirements, at 10 (Oct. 2014).

<sup>35</sup> *Id.* at 11.

<sup>36</sup> *July Communication*, *supra* note 26, at 3.

<sup>37</sup> European Commission, Ernst & Young Final Report: FTT- Collection Methods and Data Requirements, at 6 (Oct. 2014).

<sup>38</sup> *Id.* at 6.

<sup>39</sup> *Id.* at 10.

<sup>40</sup> Fulvia Astolfi and Vitto Vittore, *Italy Introduces Financial Transaction Tax*, 24 Int'l Tax Rev 67 (2013).

The United Kingdom, Belgium, France, Switzerland, and Italy have all implemented FTTs that vary drastically in scope, which can easily lead to a fragmentation of the single market. It is important that such Member States develop a coordinated framework to avoid tax arbitrage and distortion between financial markets in the European Union. Uncoordinated national taxes can lead not only to double taxation but also fragmentation of the financial sector, which will ultimately hamper the Single Market in the European Unions.<sup>41</sup> Conversely, a coordinated framework for the European Union would create a strong internal market for financial services. Such a framework would prevent tax evasion and avoidance, double taxation, and distortion of competition within the Single Market.<sup>42</sup> A unilateral tax of financial transactions would also promote EU's main goals of harmonization and a single internal by preventing distorted competition, risk of relocation of financial activities, and eliminate risk of double or non-taxation.<sup>43</sup> Moreover, coordination between Member States can help reduce administrative costs involved with tax collection.<sup>44</sup>

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<sup>41</sup> *Ibid.*

<sup>42</sup> European Commission Press Release IP/11/1085, Common Rules for a Financial Transaction Tax- Frequently Asked Questions (September 28, 2011).

<sup>43</sup> *Staff Working Document, supra* note 33, at 10.

<sup>44</sup> *Opinion of the European Economic and Social Committee on the Proposal for a Council Directive- Implementing Enhanced Cooperation in the Area of Financial Transaction Tax*, COM (2013) 71 final (Apr. 24, 2013) [hereinafter *Committee Opinion*].

## II. THE COMMISSION'S INITIAL PROPOSAL FOR A FINANCIAL TRANSACTION TAX DIRECTIVE

### A. An Overview of the Proposed Financial Transaction Tax for All Member States

The TFEU allows the Council has the power to adopt provision for harmonization of Member States in the area of taxation because it facilitates the free movement of goods and supply of services with the internal market.<sup>45</sup> However, the Council must act unanimously in the area of taxation after consulting both the Parliament and the Economic and Social Committee.<sup>46</sup> The Commission's initial proposal for the FTT was met with criticism and was not unanimously approved.

The FTT is a capital transfer tax that stems from the ideas of James Tobin, a US Economist and Nobel Laureate.<sup>47</sup> Tobin suggested that a transaction tax on all conversions of currency could mitigate excessive speculation and, thus, decrease volatility of the market.<sup>48</sup> In the original proposal for a FTT directive, the Commission expanded on James Tobin's transaction tax idea to include over the counter transactions such as purchase and sale of shares, fixed-income securities, derivatives, and currency exchange.<sup>49</sup>

The European Union derives its right to tax financial instruments from Article 113 of the Treaty on the Functioning of the European Union (TFEU).<sup>50</sup> The TFEU provides that EU may adopt provisions relating to taxation when harmonization is necessary to ensure an internal market

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<sup>45</sup> Consolidated Version of the Treaty on the Functioning of the European Union art. 115, 2008 O.J. C 115/47, at 96. [hereinafter TFEU]

<sup>46</sup> *Ibid.*

<sup>47</sup> James Tobin, *A Proposal for International Monetary Reform*, 4 E. Econ. J. 153-159 (1978).

<sup>48</sup> S. Schulmeister, M. Schratzenstaller & Picek, *A General Financial Transaction Tax. Motives, Revenues, Feasibility and Effects*, Australian Inst. of Econ. Res. (March 2008), [http://www.steuer-gegen-armut.org/fileadmin/Dateien/Kampagnen-Seite/Unterstuetzung\\_Wissenschaft/08\\_Wifo-Transaktionssteuer.pdf](http://www.steuer-gegen-armut.org/fileadmin/Dateien/Kampagnen-Seite/Unterstuetzung_Wissenschaft/08_Wifo-Transaktionssteuer.pdf).

<sup>49</sup> Cortez, *supra*.

<sup>50</sup> *Commission Staff Working Document, Impact Assessment Accompanying the Document Proposal for a Council Directive Implementing Enhanced Cooperation in the Area of Financial Transaction Tax*, at 9, COM (2013) 71 Final (Feb. 14, 2013).

and avoid distortion of competition provided, however, that the European Council approves such measures after consulting with both the European Parliament and the Economic and Social Committee.<sup>51</sup> In response to the EU's need for contributions from financial institutions, regulations of the financial market, harmonization of national FTTS, and financial autonomy, the Commission drafted a proposal for the implementation of the FTT in all Member States.

The Commission's initial proposal for FTT was filed on September 28, 2011<sup>52</sup> and explicitly set forth three major goals: 1) harmonize tax legislation concerning financial transactions to ensure proper function of European Union's internal market and avoid distortion of competition; 2) ensure that financial institutions make a fair and substantial contribution to rebuilding the economy after the recent crisis and create a level playing field with other sectors with regard to taxation; and 2) establish a regulatory framework that discourages risky transaction to enhance efficiency and stability of financial markets, and avoid future economic crises.<sup>53</sup>

The Commission's proposal was broad in scope and applied to a wide range of financial institutions, including, "investment firms, organized markets, credit institutions, insurance companies, collective investment undertakings and their managers, alternative investment funds (such as hedge funds), financial leasing companies and special purpose entities."<sup>54</sup> The scope of financial transactions tax would also be broad and would include "the scope covers instruments which are negotiable on the capital market, money-market instruments (with the exception of instruments of payment), units or shares in collective investment undertakings (which include UCITS and alternative investment funds) and derivatives agreements."<sup>55</sup>

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<sup>51</sup> TFEU art. 115.

<sup>52</sup> *Commission Proposal for a Council Directive On a Common System of FTT*, COM (2011) 549 (Sept. 28 2011) [hereinafter *Initial Proposal*].

<sup>53</sup> *Id.* at 2.

<sup>54</sup> European Commission Press Release IP/11/1085, Common Rules for a Financial Transaction Tax- Frequently Asked Questions (September 28, 2011).

<sup>55</sup> *Initial Proposal*, *supra* note 52 at 6.

Despite the broad scope of the financial transaction tax, to protect the course of a real economy in the European Unions, the proposal does not apply to certain activities. Such activities include day to day transactions between citizens and business, investment banking activities for raising capital and corporate restructuring, refinancing or public debt management, and transactions with the European Central Bank, the national banks of the Member States, the European Financial Stability Facility, the European Stability Mechanism, and the European Union.

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The FTT does not tax financial institutions as a whole, rather it levies a tax on individual transactions. The financial transaction tax discussed in the proposal would be levied at a low rate and applied to the exchange of financial instruments, such as securities, bonds, shares, and derivatives, between banks or other financial institutions established in one of the Member States with financial transaction tax jurisdiction.<sup>57</sup> This would exclude transactions between retail banks and private households or business, with the exception of the sale or purchase of bonds or shares.<sup>58</sup>

The tax rates proposed by the Commission are low enough to alleviate the risk of relocations, but high enough to guarantee revenue for the European Union and its Member States.<sup>59</sup> For example, bonds will be taxed at a rate not lower than a tenth of one percent, while derivatives would be taxed at a hundredth of one percent for each taxable party to the transaction to raise approximately sixty billion euros per year.<sup>60</sup> The tax will be applied to the gross amount of the transaction, before netting and settlement,<sup>61</sup> and will be chargeable to the financial institution when

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<sup>56</sup> *Initial Proposal, supra* note 52 at 6.

<sup>57</sup> European Commission Press Release IP/11/1085, Common Rules for a Financial Transaction Tax- Frequently Asked Questions (September 28, 2011).

<sup>58</sup> *Ibid.*

<sup>59</sup> *Ibid.*

<sup>60</sup> *Ibid.*

<sup>61</sup> *Initial Proposal, supra* note 52 at 6.

the transaction occurs,<sup>62</sup> this includes the moment of purchase or sale, lending or borrowing of securities, and conclusion or modification of a derivative agreement.<sup>63</sup>

#### B. Criticism of the Initial Proposal for a Financial Transaction Tax Directive

Critics of the financial transaction tax are also concerned that taxes on the financial sector may be redistributed to clients and average customers, and may indirectly increase the cost of capital for governments and companies. However, the Commission's goal is to cover eighty five percent of the transactions that occur between financial institutions rather than transactions with ordinary clients or average customers. Moreover, the tax passed to the consumer would be minimal.<sup>64</sup> For example, if an average customer purchases ten thousand euros worth of stock, the tax due would be ten euros.

Another concern is that the generated revenue would largely be collected in a small number of countries where such transactions are concentrated. Implementing a financial transaction would be difficult because all Member States would have to implement a tax and absorb the costs associated with administering the tax while only a few gain the revenue.<sup>65</sup> However, the cost of administering the financial transaction tax is estimated to be less than one percent of the revenue raised.<sup>66</sup> Furthermore, most transactions are conducted electronically and the tax can be collected electronically, making the financial transaction tax on the least expensive taxes to collect.<sup>67</sup>

For example, in the United Kingdom a large portion of the share are held in an electronic system. The SDRT is collected on shares through the electronic transaction system of the London

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<sup>62</sup> *Initial Proposal*, *supra* note 52 at 8-9.

<sup>63</sup> *Id* at 10.

<sup>64</sup> European Commission Press Release IP/11/1085, Common Rules for a Financial Transaction Tax- Frequently Asked Questions (September 28, 2011).

<sup>65</sup> *July Communication*, *supra* note 26, at 5.

<sup>66</sup> *FTT- Additional Analysis of Impacts and Further Clarification of Practical Functioning* (May 4, 2012) at 34, [http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/other\\_taxes/financial\\_sector/fact\\_sheet/technical\\_fiches.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/other_taxes/financial_sector/fact_sheet/technical_fiches.pdf).

<sup>67</sup> *Ibid*.

Stock Exchange.<sup>68</sup> The tax is automatically deducted by the transaction system and transferred to Her Majesties Revenue and Customs. This incorporation has made the tax a cheap for the government to collect.<sup>69</sup> This system results in a cost of .02 pence per GBP of revenue.

Additionally, part of the revenue raised by the financial transaction tax would go to benefit the European Union budget which, in turn, would be used to promote the public welfare of all European Union Member States. The proceeds of the financial transaction tax will divided between the European Union budget and the budgets of individual Member States. More specifically, the European Union intends to spend a large portion of its budget on growth, development, jobs, and issues related to climate change.<sup>70</sup> Moreover, the Commission believes that the revenue from the financial transaction tax should be applied to investment programs at the national and European Union levels in order to foster economic growth.<sup>71</sup> If the financial transaction tax were applied to throughout all the European Union Member States, the European Union would become financially autonomous, as originally stipulated by Article 201 of the Treaty of Rome.<sup>72</sup> Additionally, investors from all over the world would use the single market, thus the FTT is a good means of raising revenue at a global level to benefit the Member States.<sup>73</sup>

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<sup>68</sup> Benjamin Cortez & Thorsten Vogel, *A Financial Tax for Europe?*, EC Tax Rev. 16, 26 (2011).

<sup>69</sup> M. Hawkins & J. McCrae, 'Stamp Duty on Share Transactions: Is There a Case for Change?', Institute for Fiscal Studies 6 (2002): 5 ff.

<sup>70</sup> European Commission Press Release IP/11/1085, Common Rules for a Financial Transaction Tax- Frequently Asked Questions (September 28, 2011).

<sup>71</sup> *Committee Opinion*, *supra* note 44.

<sup>72</sup> *Ibid.*

<sup>73</sup> *FTT- Additional Analysis of Impacts and Further Clarification of Practical Functioning* (May 4, 2012) at 34.



### III. USE OF ENHANCED COOPERATION PROCEDURE TO IMPLEMENT A FINANCIAL TRANSACTION TAX

#### A. Overview of the Enhanced Cooperation Procedure

The Commission's first proposed directive for the financial transaction tax in the European Union did not receive unanimous support in the Council. However, this proposal motivated eleven Member States to make an official request to the Commission to use the enhanced cooperation procedure to establish a financial transaction tax in between the said states.<sup>74</sup> When Member States are prevented from advancing with a common goal because of reluctance and non-agreement of others, Article 20 of the Treaties of the European Union (TEU) and Articles 326 to 334 of the TFEU allows for a group of Member States to move ahead with an initiative proposed by the Commission when unanimous agreement on it is not possible.<sup>75</sup>

The enhanced cooperation procedure requires that: (1) at least nine Member States participate, (2) unanimity cannot be achieved on the particular proposal within a reasonable time, (3) Member States must send an official request to the Commission, setting out the scope of the desired objective, (4) the Commission analyze the request and submits its decision to the European Council, (5) a qualified majority of Member States agree to the Decision and authorize enhanced cooperation, (5) the European Parliament gives its consent.<sup>76</sup>

Since the Member States have not been able to reach a unanimous agreement on the financial transaction tax, only eleven Member States decided to pursue the initiative through enhanced cooperation.<sup>77</sup> In 2013, Denmark, France, Austria, Belgium, Greece, Italy, Portugal,

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<sup>74</sup> *Initial Proposal*, *supra* note 52 at 6.

<sup>75</sup> Consolidated Version of the Treaty on European Union art. 20, 2010 O.J. C 83/01, at 29.

<sup>76</sup> *Ibid.*

<sup>77</sup> European Commission Press Release MEMO/12/799, Enhanced Cooperation on Financial Transaction Tax- Questions and Answers (October 23, 2012).

Slovakia, Slovenia, Germany, and Spain were permitted to apply a European Union financial transaction tax through enhanced cooperation.<sup>78</sup>

When deciding whether enhanced cooperation is warranted pursuant to the TFEU, the Commission must evaluate whether the cooperation in this area would (1) further the EU objectives, (2) have any negative impact on the Internal Market, such as creating a barrier to trade or distorting competition, and (3) respect the rights, competences, and obligation of non-participating Member States.<sup>79</sup> In its decision, the Commission maintained that the proposal for enhanced cooperation in the area of the FTT would support the EU's objectives of forming a strong internal market because it would harmonize the participating Member States' approach to the FTT, leading to less competitive distortion, less opportunities to avoid tax, greater transparency and information exchange, and fewer compliance costs for businesses.<sup>80</sup> Further, the Commission feels that the FTT would provide a common system of taxation for financial institutions without harming the rights, competences, and obligations of non-participating Member States.<sup>81</sup>

After enhanced cooperation in the area of the FTT was authorized by the Economic and Financial Affairs Council and the European Parliament, the Commission drafted a second proposal to be implemented by the eleven Member States who wished to participate in the enhanced cooperation for a common system of financial transaction tax.<sup>82</sup> This was only the third time enhanced cooperation pursuant to Article 20 of the TEU and Articles 326 to 334 of the TFEU has

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<sup>78</sup> European Commission Press Release IP/12/1138, Commission Proposes Green Light for Enhanced Cooperation on Financial Transaction Tax (October 10, 2012).

<sup>79</sup> TFEU art. 327.

<sup>80</sup> European Commission Press Release MEMO/12/799, Enhanced Cooperation on Financial Transaction Tax- Questions and Answers (October 23, 2012).

<sup>81</sup> *Ibid.*

<sup>82</sup> *Committee Opinion*, *supra* note 44.

been used by the Member States to carry out a particular objective, and the first time in the area of tax.<sup>83</sup>

When the aforementioned steps are completed, all members of the Council are entitled to participate in the deliberation of the enhanced cooperation proposal. However, only the Member States who will be participating can take part in the vote.<sup>84</sup> As of 2015, the eleven Member States who have expressed the wish to participate in the enhance cooperation in the area of the FTT have not reached an agreement as to whether the Commission's proposal for enhanced cooperation should be adopted. Once Member States reach an agreement as to the provisions that should be included in the proposal and the proposal is adopted, the framework is only binding on the participating Member States.<sup>85</sup>

While there are only eleven Member States that have expressed interest in cooperating in the area of the FTT, the enhanced cooperation will remain open to all Member States wishing to join. Further, the TFEU mandates that the participating Member States promote, to the best of their ability, participation by Member States.<sup>86</sup> Moreover, the application of the financial transaction tax in this limited zone can lead to future application worldwide.<sup>87</sup>

#### B. The Commission's Proposal for a Council Directive- Implementing Enhanced Cooperation in the Area of a Financial Transaction Tax

The Commission's proposal for enhanced cooperation in the area of the FTT largely mirrors the Commission's initial proposal. The three original objectives of strengthening the single financial market by elimination individual national approaches to taxation of the financial

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<sup>83</sup>Council of the European Union Press Release 5555/13, Financial Transaction Tax: Council Agrees to Enhanced Cooperation (January 22, 2013).

<sup>84</sup> Consolidated Version of the Treaty on European Union art. 20, 2010 O.J. C 83/01, at 30.

<sup>85</sup> *Ibid.*

<sup>86</sup> TFEU art. 238.

<sup>87</sup> *Committee Opinion*, *supra* note 44.

transactions, ensuring that the financial sector makes a fair contribution to the economy, and promoting investment in the economy remain. However, several changes were made to strengthen the anti-abuse and anti-avoidance provisions.<sup>88</sup>

The most prominent and controversial change was the addition of the “counterparty principal.”<sup>89</sup> This is largely due to the fact that the proposal for enhanced cooperation in the area of the FTT only applies to eleven Member States rather than the entire EU area. As mentioned above, the initial proposal for a directive focused on the “residence principal.” That is, a party to a transaction would be subject to the FTT in the Member State where it resides.<sup>90</sup> The Commission extended the taxable base to include all parties that are privy to a financial transactions where at least one party to the transaction is established in a Member State with FTT Jurisdiction.<sup>91</sup> The Commission’s purpose in taxing transactions where at least one party is located in a financial transaction tax jurisdiction is to safeguard tax neutrality and so that Member States receive fair and substantial contributions from financial institutions to cover the cost of the recent economic crisis.<sup>92</sup> The European Parliament also suggests taxation of financial instruments owned by residents of Member States to make financial transaction tax avoidance risky and expensive for financial institutions.<sup>93</sup> This results in a wide tax base for the FTT even if only eleven of the Member States are involved.

The Commission urges Member States to extend the scope of proposal even further to include transactions where products were issued in a Member State but not traded by parties who are not part of the European Union.<sup>94</sup> Taxing such transaction could further assist participating

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<sup>88</sup> *Enhanced Cooperation Proposal*, *supra* note 2.

<sup>89</sup> *Id.* at 23.

<sup>90</sup> *Initial Proposal*, *supra* note 52 at 8.

<sup>91</sup> *Enhanced Cooperation Proposal*, *supra* note 2, at 23.

<sup>92</sup> *Staff Working Document*, *supra* note 33, at 39.

<sup>93</sup> *Ibid.*

<sup>94</sup> *Staff Working Document*, *supra* note 33, at 40.

Member States in fighting tax evasion and relocation of financial institutions. This would also allow Member States to tax an additional ten percent of financial transactions issued issues in the eleven Member States participating in enhanced cooperation, which would result in over a billion euros in additional revenue.<sup>95</sup>

Critics of the FTT believe that the tax will result in financial institutions relocating to tax jurisdictions without such a tax. Conversely, the Commission believes that using a broad base, that utilizes the residence principal, counterparty principal, and issuance principals, would reduce the risk of relocation because all financial centers, such as Frankfurt, would be taxed in the same way and only financial institutions that did not serve European Union clients or did not take place in the European Unions would not be taxed.<sup>96</sup> Further, even if financial institutions relocate to a jurisdiction with no financial transactions tax, they would not be able to avoid taxation as the counterparty or the client on behalf of whom the institution is acting is established in a financial transaction tax jurisdiction.<sup>97</sup> In order to completely avoid tax, a financial institutions would have to entirely abandon its client base.<sup>98</sup> This would be unreasonable and costly for the financial institutions.

Furthermore, the eleven Member States involved in the enhance cooperation account for at least two thirds of the European Union GDP and ninety percent of the total European GDP. Thus, it would be nearly impossible for an institution to avoid any interaction with all of the eleven Member States to avoid the financial transaction tax.<sup>99</sup> This may encourage non participating

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<sup>95</sup> *Ibid.*

<sup>96</sup> European Commission Press Release IP/11/1085, Common Rules for a Financial Transaction Tax- Frequently Asked Questions (September 28, 2011).

<sup>97</sup> *Staff Working Document*, *supra* note 33, at 40.

<sup>98</sup> *Id.* at 18.

<sup>99</sup> *Committee Opinion*, *supra* note 44..

countries to enact a FTT and lead to negotiations with third party countries to facilitate financial transaction tax collection.<sup>100</sup>

### C. Effects of the Enhanced Cooperation of Non-Participating Member States

The decision authorizing enhanced cooperation was made by a qualifying majority at the Economic and Financial Affairs Council. Czech Republic, Luxembourg, Malta, and the United Kingdom abstained.<sup>101</sup> The United Kingdom proceeded to challenge the Council's decision on the enhanced cooperation in the area of financial transaction tax in the Court, alleging that an adoption of the financial transaction tax would produce extraterritorial effects and impose costs on non-participating Member States.<sup>102</sup> The Court dismissed the action, finding that the claim was premature because the tax had not yet been implemented.<sup>103</sup>

The United Kingdom's challenge has added to the debate surrounding the "counter-party principle" in Article (4)(1)(f) of the Commission Proposal for a Council Directive implementing the financial transaction tax. Under the "counterparty principle" financial institutions established in a non-participating Member States are liable for the financial transaction tax if enters a transaction with a party located in a participating Member State.<sup>104</sup> The Commission has determined that such a transaction results in a sufficient nexus with the participating Member State.<sup>105</sup>

The Commission has also found the proposal to "respect the competences, rights, and obligations of the Member states not participating in the enhanced cooperation" and compatible

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<sup>100</sup> *Ibid.*

<sup>101</sup> Council of the European Union Press Release 5555/13, Financial Transaction Tax: Council Agrees to Enhanced Cooperation (January 22, 2013).

<sup>102</sup> Case C-209/13, United Kingdom of Great Britain and Northern Ireland v. Council of European Union, 2013

<sup>103</sup> *Financial Transaction Tax (FTT): Legality of the "Counter Party Principle" Laid Down in Article 4(1)(f) of the Commission Proposal for a Council Directive Implementing Enhanced Cooperation In the Area of FTT*, at 1, COM (2013) 71 final (Feb. 14, 2013) at 7.

<sup>104</sup> *Ibid.*

<sup>105</sup> *Ibid.*

with Article 327 of the TFEU<sup>106</sup> because the counterparty principal is only triggered if there is a nexus with a participating Member State. Furthermore, the proposal complies with Article 326 of the TFEU and the fundamental freedoms. This is because the counterparty principal does not discriminate or distort competition between financial institutions because it only concerns the allocation of taxing powers.<sup>107</sup>

Interestingly, as mentioned in Section I, United Kingdom already has an FTT. The United Kingdom currently has a stamp duty for paper transactions and Stamp Duty Reserve Tax for electronic transactions. Both types of tax are levied on the transfer of shares in the UK incorporated companies, regardless of where the transactions takes place.<sup>108</sup> While the UK is opposed to enhanced cooperation in the area of the FTT, it has a long standing nation FTT that has resulted had any significant negative effects on the financial market.<sup>109</sup>

Another EU Member State that has levied its own FTT is France. Following the introduction of a national tax on financial transactions in France, the Commission conducted a trend analysis on the influence of the financial transaction tax on trading volumes, prices levels, and volatility of the financial market.<sup>110</sup> Specifically, France had instituted a 0.2% tax on the transfer of ownership of shares on companies established in France. The taxes were paid by the purchaser on the net transaction. In 2012, this tax resulted in one hundred ninety nine million euros, and is expected to generate approximately seven hundred million euros in 2014.<sup>111</sup>

The analysis investigated the effect on trading volumes, share prices, and volatility in France over a nineteen month period in comparison to financial markets in other countries.<sup>112</sup>A

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<sup>106</sup> *Ibid.*

<sup>107</sup> *Ibid.*

<sup>108</sup> Cortez, *supra* at 26.

<sup>109</sup> *Id.* at 27

<sup>110</sup> French Trend Analysis, *supra* note 19.

<sup>111</sup> *Id.* at 2.

<sup>112</sup> *Ibid.*

financial transaction tax on shares had potential to negatively impact the financial market because some investors might withdraw from the market if they cannot pass on the costs to the sellers or clients and some investors might engage in substitution activities by purchasing untaxed or lower taxed products such as derivatives.<sup>113</sup> A decline in trading volumes would, in turn, cause higher volatility in the market. The Analysis found that trading volumes did suffered setback when the financial transaction tax was first introduced.<sup>114</sup> However, there was no negative impact on price levels of shares.<sup>115</sup> Additionally, the analysis was not clear on whether there was a correlation between the financial transaction tax and the volatility of the market.<sup>116</sup>

On the other hand, with regard to revenue generated by the financial transaction tax for France, the analysis found that assuming a tax rate of one tenth of one percent, the estimated tax revenues would have be about sixty billion euros for stocks and bonds in 2016. If derivatives were included, the total would increase considerably.<sup>117</sup> However, it is difficult to determining tax bases and estimating the revenue accurately in order to tax derivatives.<sup>118</sup> The study showed that it is difficult to predict the effect of a financial transaction tax on volume, share prices, and volatility, but there were no drastic negative effects. The study certainly proved that a financial transaction tax can be a great source of revenue for the government.

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<sup>113</sup> *Id.* at 5.

<sup>114</sup> *Ibid.*

<sup>115</sup> *Ibid.*

<sup>116</sup> *Ibid.*

<sup>117</sup> *July Communication, supra* note 26, at 4.

<sup>118</sup> *Ibid.*



#### D. Issues with Utilizing Enhanced Cooperation Procedure to Implement a Financial Transaction Tax

Because not all Member States of the European Union are part of the enhanced cooperation in the field of financial transaction taxations, double taxation within the European Union cannot be eliminated.<sup>119</sup> Non-participating Member States will continue to change means of taxing financial institutions at any time as long as their law comply with European Union legislation and international law.<sup>120</sup> In doing so, non-participating Member States will continue to fragment the single market that the European Union is trying to achieve.<sup>121</sup>

Moreover, under enhanced cooperation, non-participating Member States can avoid a financial transaction tax only by interacting with other parties not established in participating Member States. If the financial transaction was applied to all Member States, there would be no issue of double taxation or non-taxation. Financial transaction tax critics are concerned that financial center would be less attractive if a common system for financial taxation is established. However, establishing a common system of taxation would also alleviate the issue of relocation because all Member States would be effected equally.<sup>122</sup>

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<sup>119</sup> *Staff Working Document*, *supra* note 33, at 16.

<sup>120</sup> *Ibid.*

<sup>121</sup> *Ibid.*

<sup>122</sup> *Ibid.*

## CONCLUSION

The recent economic and financial crisis caused primarily by financial institutions has forced the EU and the Member States debt levels to rise significantly and highlighted the lack of regulatory framework in the financial sector in the European Union. Nevertheless, financial institutions in the European Union continue to benefit from protection the governments offered during the 2007 economic crisis while enjoying high profit margins.<sup>123</sup> Despite their involvement in the financial crisis, financial institutions continue to generate profit while receiving preferential treatment in the area of tax, such as exemptions from paying value added tax because of the difficulties in measuring taxable bases.<sup>124</sup> A financial transaction tax will force financial institutions to make a fair and substantial contribution to Member States' government and the European Union.

Moreover, a coordinated financial transaction tax between the Member States is a way for the European Union to regulate the financial sector. Specifically, a tax on financial transactions will discourage high risk transaction and enhance the stability of the financial market, and harmonize the financial transaction tax between Member States to promote a single integrated market. Most importantly, the financial transaction tax will force financial institutions to contribute a fair share to the European Union economy.

The financial transaction tax would provide both the national governments and the European Union with significant revenue at little cost. While only eleven of the Member States have shown interest in the enhanced cooperation, the Commission's proposal created a wide tax base through the use of the residence, counterparty, and issuance principals. Moreover, because

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<sup>123</sup> European Commission Press Release IP/11/1085, Common Rules for a Financial Transaction Tax- Frequently Asked Questions (September 28, 2011).

<sup>124</sup> *Id.*

financial markets are becoming increasingly interconnected the revenue will not only come from Member States but also from financial institutions around the world doing business with parties from the Member States. The wide tax base of the FTT make its incredible difficult to avoid the FTT, which may encourage other Member States to join the enhanced cooperation to also benefit from the revenue. Implementing the Commission's proposal for a financial transaction tax at the European Union level first may also help promote the tax at a global level.